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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2018/2019

BAC3654 – PROFESSIONAL ETHICS

(All sections / Groups)

16 OCTOBER 2018
9.00 a.m – 12.00 p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 5 pages with 4 Questions only (excluding the cover page).
2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

TRI Berhad (TRI) is a well-established public company listed on the Malaysian Stock Exchange, Bursa Malaysia. It is currently undergoing its statutory annual audit from the reputable firm of accountants Hamzah, Wong & Partners, who have been its auditors and business advisors for more than 10 years. Over this period the managing partner of Hamzah, Wong & Partners has become a very good friend of the chief executive officer of TRI (CEO), and their families regularly holiday together.

The chairman of TRI is expecting the audit to be signed off, but the audit partner managing the audit has suspicions around the adequacy of a series of provisions and whether contingent liabilities noted in the accounts would not more accurately be accounted for as provisions. She also disagrees with the capitalisation of research expenditure and other intangible assets on the statement of financial position, rather than treating them as expenses in the income statement. She has questioned the financial controller, who is a professionally qualified accountant, about these matters but is getting minimal cooperation from him. It appears that the chief financial officer (CFO) has pressurised the financial controller to apply these accounting policies, as he has himself been pressurised by the CEO to ensure that profits over the next two years are presented favourably towards the time which the CEO's share options can be exercised.

The audit partner herself is being pressurised by the managing partner of Hamzah, Wong & Partners to sign off the accounts as a 'true and fair view' and not to challenge the accounting policies of the company, as the renewal of the audit contract with TRI is imminent.

Required:

(a) Describe the primary roles of a chief executive officer (CEO), and criticise the actions of the TRI CEO described in the scenario, recommending more appropriate behaviour.

(7 marks)

(b) Explain the threats to independence to the Hamzah, Wong & Partners audit team, the CFO and the financial controller of TRI which arise from this situation.

(6 marks)

(c) Recommend suitable safeguards at TRI and Hamzah, Wong & Partners to prevent such conflicts as identified in the scenario, and to address the threats to independence identified.

(12 marks)

(Total 25 marks)

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QUESTION 2

Sinar Kuning (SK) is a listed company that designs and installs advanced technology computer equipment used by multinational manufacturing companies. SK is located in Malaysia but almost 90% of its sales are exported. SK has sales offices in Europe, the Pacific, Africa and North and South America.

The majority shareholder of SK is Tan Sri Ali Baba (TSAB), an entrepreneur who is a risk taker both personally and in business. It was rumoured that he amassed great wealth through speculating in high risk products in his younger days. The Board of directors comprises four members but they are effectively controlled by TSAB who is both the chairman and chief executive officer of the company. The three other directors were appointed by TSAB. They are his wife, who has a marketing role in the business, and two non-executive directors, one provides advisory services to SK and the other a long-time family friend who is a professor. Additionally none of the Board level sub committees exist in SK. Board meetings are held quarterly and mainly informal, largely led by TSAB's verbal review of sales activity. Sometimes, board resolutions are circulated via emails and endorsed without much deliberation. The board members trust TSAB completely and leave the running of the company to him. In return, TSAB remunerated them much higher than the market rate.

TSAB doesn't believe in having a sound framework for internal controls and risk management. In addition, the board does not encourage employees to report genuine concerns in relation to breach of a legal obligation (including negligence, criminal activity, breach of contract and breach of law), danger to health and safety or to the environment and these incidences are normally cover-up in the workplace.

Required:

a) Write a report to the Board of SK, critically evaluating the company's current corporate governance practices and recommend the improvements to the board structures and processes.

(10 marks)

b) Advise SK on the roles and responsibilities of the audit, remuneration and nomination committees. Include in your discussion, why it is important to have sound internal control and risk management in SK.

(12 marks)

c) Discuss about the culture in SK with regards to reporting of misdoings. What would you recommend to the board?

(3 marks)

(Total 25 marks)

Continued...

QUESTION 3

Rivermouth, a large and fast growing city in Deeland, is desperately in need of additional supplies of clean water to meet the increasing demand from its growing population. The local water authority has commissioned a private company, Beautiful Water Consortium (BWC), to carry out this project. BWC is optimistic that this project can generate a reasonable of profit of at least 10% profit. A suitable location near to the village of Bayswater, a site less than 10 kilometres from the city, with a substantial underground reserve of natural water, has been identified. But this land is owned by a prominent local businessman, Roger Duke, with powerful connections and influence over some of the key ministers in the national government. He has been effectively lobbying government to ensure that the construction of the necessary water pipe channels from his land to the city of Rivermouth will not happen, even though it would have a minimal adverse effect on the local natural environment and people; furthermore it would create more jobs in this economically challenged region.

An alternative proposal from the BWC is to build a huge dam at the bottom of the Creek Valley, which is in the neighbouring administrative region of Lambda about 60 kilometres from Rivermouth. The effect would be to create a large reservoir from which water could be diverted to Rivermouth. The cost of this proposal is six times greater than the original Bayswater option, and would also lead to hundreds of people being relocated to a town to the east of the new dam construction due to their homes being submerged. In addition, the dam project would include major tunnel building and blasting to channel the water from the newly created reservoir to the city of Rivermouth. This would be through a series of mountains and valleys, many of which lie in an area of outstanding natural beauty and contain many endangered species of animals and birds. The Deeland government has stipulated that the total cost of the Creek Valley project is to be recovered through a special water services tax on Rivermouth's householders and the population of Lambda, which already has access to more water than it requires. By contrast the Bayswater solution would not require extra taxes to be paid; on a positive note, the Creek Valley project will create many more construction jobs than the Bayswater option would require and is located in the relatively much poorer region of Lambda.

When the national government of Deeland finally decided on the costlier Creek Valley proposal, there were large demonstrations in Lambda. The demonstrators comprised many disparate groups objecting to the forced relocation of the population, damage to the natural environment and more generally about the additional costs to taxpayers of this much more expensive and disruptive project. The senior management of BWC doesn't know how to handle this crisis and anticipate more problems ahead.

Required:

(a) Identify the key stakeholders and their interests. Also show in a table on the interactions of stakeholders and interests against the legitimacy, legal and urgency dimensions as in the Mitchell, Agle and Wood model (1997).

(7 marks)
Continued...

(b) Using Tucker's 5-question model, evaluate the moral case for or against obtaining the water from the Creek Valley in Lambda, rather than from Bayswater.

(10 marks)

(c) Does the demonstration by the residents create ethics risk? If so, how will the reputation of BWC and the government of Deeland be affected by the mass demonstration if it is not handle properly? What steps could be done to restore its reputation immediately after the demonstration? Suggest an alternative way to resolve this problem?

(8 marks)

(Total 25 marks)

QUESTION 4

Richie Smith joined TMC and rapidly moved up to become the financial controller. However during the four years that he worked, he had participated in several frauds.

The management of TMC gave clear guidelines with respect to accounts receivable and bad debts limits. Accounts that were 90 days or more should not exceed 7 % of total receivables and bad debts written off should be under 2 % of total receivables. TMC capped the bad debt at 12 million for the previous year but reduced it to 10 million in the current year even though revenue has increased. Unfortunately, both delinquent accounts and bad debts exceeded this guidelines. So Richie instructed his staffs to manipulate the accounts. A year later, he heard that there might be a take-over of TMC and was told to show good financial performance so that they can become rich. He was paid well as well as was given some stock options. The upper management of TMC encouraged the finance staffs to use a number of techniques to minimise the high bad debts. They commented him as a "solutions provider" for TCM in managing the exposure to bad debts. He receive a pat on his back from his superiors and he passed on the favour by praising his staff too.

He went on to commit more crimes. In order to hide the overdue accounts receivable, he signed bank guarantee documents on behalf of this company without his boss knowledge to reimburse the bank if they couldn't collect from the customers. He also colluded with an unscrupulous customer, Mann to rip off TMC and a bank by sharing the money earned from this unethical act. In the process, he was told by Mann "you can't steal what they are not going to get as TMC will write off the bad debts one day". As time went on, Richie feels that TMC owed him and that he was entitled to help himself by engaging in fraud. He was of the view that the senior executives knew what is going on and were turning a blind eye to the hiding of the bad debt problem. He believed that they knew that the accounting and reporting systems were a scam. He reasoned that everyone else was doing it, so why shouldn't he? When his crimes were uncovered, Richie justified that he had to provide luxuries for his family and sustain an expensive lifestyle.

Required:

a) What motivated Richie to become involved in fraudulent behaviour?

(2 marks)

Continued...

b) How did he rationalise the actions he took using the fraud diamond or any of the Heath's seven common unethical rationales framework?

(10 marks)

c) What are the risks for TMC in setting unrealistic allowance for doubtful debts?

(3 marks)

d) What governance measures might have protected TMC if they had been in place and enforced?

(10 marks)

(Total 25 marks)

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